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BELLAJADE SDN BHD v. CME GROUP BHD & ANOR

HIGH COURT MALAYA, KUALA LUMPUR
AZIZUL AZMI ADNAN JC
[CIVIL SUIT NO: 22NCVC-19-01-2014]
10 JUNE 2015

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CONTRACT: *Tenancy agreement – Rent – Default in payment – Claim to recover arrears in rental – Tenancy agreement provided that premise could be used for commercial purpose – Discovery of express condition of title for lands on which property was located to be used only as residential purpose during land search – Assignment of benefit under tenancy agreement to bank – Default of rental by tenant – Whether owner of property had locus to commence claim – Whether tenancy agreement contravened express condition of title – Whether tenancy agreement illegal and void ab initio – Whether guarantor liable under guarantee agreement for arrears in rental under tenancy agreement – Whether tenant entitled to recover payments of rental previously – Contracts Act 1950, s. 66*

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The first defendant entered into a tenancy agreement with the plaintiff for a property known as Plaza Palas ('the property'). The second defendant, as guarantor, gave certain undertakings to the plaintiff in a guarantee of tenancy agreement ('the guarantee agreement') to guarantee the payment obligations of the first defendant under the tenancy agreement. The plaintiff had assigned the benefit of the tenancy agreement ('assignment of tenancy') to OCBC Bank (Malaysia) Berhad ('OCBC Bank'). The assignment of tenancy provided for an absolute assignment of the plaintiff's rights, title and interest in the tenancy agreement to OCBC Bank. Section H of the First Schedule to the tenancy agreement specified that the use of the property was for commercial purposes. By the terms of the tenancy agreement, the first defendant was deemed to have taken possession of the property upon completion of the sale and purchase agreement entered into between the plaintiff and the previous owner of the property. The sale and purchase agreement was deemed completed, despite the existence of certain disputes between the plaintiff and the previous owner. The first defendant had paid rental for the first six months of the tenancy. However, when the first defendant came to know of the dispute between the plaintiff and the previous owner of the property, it conducted a land search and discovered that the express condition of title for the lands on which the subject properties were located was to be used only as residential purpose. Further, the Dewan Bandaraya Kuala Lumpur had issued a certificate of fitness for occupation confirming that the property was fit to be occupied for its purpose. The plaintiff, in addition, led evidence to show that the category of land use of the property was on the process of being converted. In consequence, the first defendant defaulted in the payment of rental to the plaintiff. The plaintiff, therefore, commenced the present action against the first defendant to recover arrears in rental under the tenancy agreement, and against the second defendant, who had guaranteed the

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obligations of the first defendant under the tenancy. The issues that arose for the court's determination, *inter alia*, were (i) whether the plaintiff had *locus* to prosecute its claim under the tenancy agreement in the light of the fact that it had assigned its rights, title to and interest in the tenancy agreement to OCBC Bank; (ii) whether the tenancy agreement was illegal and *void ab initio* on the basis that the contemplated use of the premises contravened an express condition of title; (iii) whether the first defendant was entitled to recover payments of rental previously made; and (iv) whether the second defendant was liable under the guarantee agreement for the arrears in rental under the tenancy agreement.

Held (dismissing plaintiff's claim against first defendant and guarantor with cost; allowing first defendant's counter claim):

(1) The assignment of tenancy was, on its true construction, not an absolute assignment of the tenancy agreement, but merely an assignment by way of security. Therefore, the plaintiff did not lack *locu*s to prosecute the claim. The tenancy agreement was illegal on the basis that the contemplated use of the premises contravened the express condition of title for the land. The tenancy agreement was accordingly void, and the plaintiff may not claim for the arrears in rental from the first defendant. (para 15)

(2) The fact that the certificate of fitness for occupation had already been issued had no bearing on the express condition of title. In addition, the fact that the process of conversion had been commenced did not change the fact that the express condition of title prohibited the use of the building for the purposes specified in section H of Schedule 1 of the tenancy agreement. It was clear that these purposes contemplated the ability of the first defendant to use the premises for commercial purposes and to sub-let portions of the premises to businesses and retailers, which would not come within the category of residential. (para 27)

(3) The first defendant did not know of the contravention of the express condition of title at the time it entered into the tenancy agreement. Therefore, s. 66 of the Contracts Act 1950 applied, in that the tenancy agreement was a contract that was 'discovered to be void' within the meaning of s. 66. The first defendant may therefore claim for the return of the rental payments previously made to the plaintiff. (para 15)

(4) The guarantee was, on its true construction, a contract of guarantee and indemnity. As such, the guarantor undertook obligations as principal *vis-à-vis* the plaintiff. The obligations of the guarantor accordingly remained extant notwithstanding that the tenancy agreement was found to be void. However, based on the principle that the courts would not permit a person to claim a remedy under an illegal transaction in which he had participated, thus, the plaintiff's claim against the guarantor was disallowed. (para 15)

A **Case(s) referred to:**
Singma Sawmill Co Sdn Bhd v. Asian Holdings (Industrialised Buildings) Sdn Bhd [1979] 1 LNS 96 FC ***(refd)***
Soh Eng Keng v. Lim Chin Wah [1979] 1 LNS 98 HC ***(refd)***
Vijayalakshmi Devi Nadchatiram v. Saraswathy Devi Nadchatiram [1996] 4 CLJ 430 HC ***(refd)***

B **Legislation referred to:**
Contracts Act 1950, ss. 24, 66

For the plaintiff - Michele Kaur; M/s Sun & Michele
For the 1st defendant - K Kirubakaran (S Malar with him); M/s Kiru & Yong
C *For the 2nd defendant - KY Sim; M/s Faizul Nasir & Assocs*

Reported by Sandra Gabriel

JUDGMENT

D **Azizul Azmi Adnan JC:**

Introduction

[1] The plaintiff commenced this action against the first defendant to recover arrears in rental under a tenancy agreement, and against the second defendant, who had guaranteed the obligations of the first defendant under
E the tenancy.

[2] On 20 May 2015, I dismissed the plaintiff's claim against both the first and second defendants, and allowed the counterclaim of the first defendant for the return of money previously paid under the tenancy. The plaintiff filed
F a notice of appeal on 3 June 2015.

[3] These are the grounds for my decision.

Salient Facts

[4] On 21 February 2013, the first defendant, CME Group Berhad
G (CME), as tenant, entered into a tenancy agreement (the tenancy agreement) with the plaintiff, Bellajade Sdn Bhd (Bellajade). The property that was the subject matter of the tenancy agreement was Plaza Palas in Ampang.

[5] By the terms of the tenancy agreement, CME was deemed to have taken possession of the subject property upon completion of the sale and
H purchase agreement entered into between Bellajade and the previous owner of the property. In a separate ruling on a preliminary point of law made prior to trial, I determined that the sale and purchase agreement had been completed, notwithstanding the existence of certain disputes between Bellajade and the previous owner.

I **[6]** CME only paid rental for the first six months of the tenancy.

[7] The second defendant (the guarantor) gave certain undertakings to Bellajade in a document described as guarantee of tenancy agreement (the guarantee). By this guarantee, the guarantor undertook, *inter alia*, to guarantee the payment obligations of CME under the tenancy agreement.

[8] Section H of the First Schedule to the tenancy agreement specified the use of the property as follows:

> Lounge, private club, recreational premises and entertainment/ recreational bistro, convenient shop [*sic*], café, hair saloon [*sic*], fitness centre, clinic, laundry, beauty saloon [*sic*], florist, banking services and facilities, food court, fast food outlets and office.

[9] When CME came to know of the dispute between Bellajade and the previous owner of Plaza Palas, it conducted land searches over the subject properties, the results for which were obtained on 28 October 2013. These land searches revealed that the express condition of title for the lands on which the subject properties were located provided as follows:

> Tanah yang dimaksudkan hendaklah digunakan semata2 untuk rumah kediaman.

[10] Dewan Bandaraya Kuala Lumpur had issued a certificate of fitness for occupation to the previous owners of the property confirming that the premises in question was fit to be occupied and fit for its purpose. The counsel for the plaintiff led evidence to show that the category of land use of the premises was in the process of being converted, and that the office of the Director of Land and Mines had assessed additional premium payable for the conversion. This additional premium had not been paid, due to the dispute between Bellajade and the previous owners of the property.

[11] Bellajade had assigned the benefit of the tenancy agreement to OCBC Bank (Malaysia) Berhad (OCBC Bank), under a document described as an assignment of tenancy dated 1 November 2013. The operative provision of the assignment of tenancy appeared to provide for an absolute assignment of Bellajade's rights, title and interest in the tenancy agreement.

Issues

[12] The issue of whether the tenancy agreement has commenced and whether vacant possession has been delivered to CME has been determined pursuant to my ruling of 3 December 2014. In this ruling, I found that the price adjustment clause in the sale and purchase agreement entered into between Bellajade and the previous proprietor of the subject properties was a post-completion obligation, and that accordingly the sale and purchase agreement had completed. Therefore, the tenancy under the tenancy agreement had commenced, and CME was deemed to have obtained possession of the premises upon completion of the sale and purchase agreement.

[13] In the course of trial, CME abandoned its argument that, at the time possession of the premises was deemed to have been given to CME, the premises were not in a condition that allowed CME to occupy and carry on its business in the premises or to sub-let the premises.

[14] I have reframed and distilled the remaining issues for trial into the following:

(a) whether Bellajade as plaintiff had locus to prosecute its claim under the tenancy agreement, in the light of the fact that it had assigned its rights and title to, and interest in, the tenancy agreement to OCBC Bank;

(b) whether the tenancy agreement was illegal and void *ab initio* on the basis that the contemplated use of the premises contravened an express condition of title, and consequently whether CME was liable to pay the outstanding rental under the tenancy agreement, or whether it was entitled to recover payments of rental previously made; and

(c) whether the guarantor was liable under the guarantee to Bellajade the plaintiff for the arrears in rental and the failure of CME to fulfil its payment obligations under the tenancy agreement.

Summary Of Findings And Decision

[15] The findings of this court are summarised as follows:

(a) the assignment of tenancy was, on its true construction, not an absolute assignment of the tenancy agreement, but merely an assignment by way of security. Therefore, Bellajade did not lack locus to prosecute the claim;

(b) the tenancy agreement was illegal on the basis that the contemplated use of the premises contravened the express condition of title for the land. The tenancy agreement was accordingly void, and Bellajade may not claim for the arrears in rental from CME;

(c) this court found as a matter of fact that CME did not know of the contravention of the express condition of title at the time it entered into the tenancy agreement. Therefore, s. 66 of the Contracts Act 1950 applies, in that the tenancy agreement was a contract that was "discovered to be void" within the meaning of s. 66. CME may therefore claim for the return of the rental payments previously made to Bellajade;

(d) the guarantee was, on its true construction, a contract of guarantee and indemnity. As such, the guarantor undertook obligations as principal *vis-à-vis* the plaintiff. The obligations of the guarantor accordingly remained extant notwithstanding that the tenancy agreement was found to be void. However, based on the principle that the courts will not permit a person to claim a remedy under an illegal transaction in which he has participated, Bellajade's claim against the guarantor was disallowed.

[16] I awarded costs of RM30,000 for CME and RM20,000 for the guarantor against Bellajade.

[17] The analyses underlying these findings are set out in the following paragraphs.

Locus Standi

[18] Counsel for CME sought to argue that Bellajade did not have the locus to sue CME under the tenancy agreement, as Bellajade had assigned absolutely all its rights, title and interest to and in the tenancy agreement to OCBC Bank. In order to sue under the tenancy agreement, counsel for the first defendant argued that Bellajade would have to sue in the name of OCBC Bank.

[19] The operative provision of the assignment clause in the assignment of tenancy provided as follows:

> As security for the Indebtedness, the Assignor hereby ASSIGNS absolutely unto the Bank all its rights title interest and benefit in and to the Tenancy Agreement (including without limitation all rental proceeds and other monies now due or to become due to the Assignor from the Tenant under and pursuant to the Tenancy Agreement) and all rights powers and remedies of the Assignor for the enforcement of any breach by the Tenant under the terms of the Tenancy Agreement and all its present and future right to pursue any action, proceeding, suit or arbitration arising in relation to any of the rights assigned to the Bank pursuant to this Section and to enforce the rights in the name of the Bank or of the Assignor.[1]

[20] Despite the plain words of this clause, it is tolerably clear that from the document itself that the assignment was intended to secure a debt owed by a third party to OCBC Bank. The opening words of cl. 3.02 quoted above leaves no doubt that the assignment is by way of security, and sch. 1 to the assignment of tenancy provided details of the borrower and the facility agreement intended to be secured by the assignment of tenancy.

[21] The opening words of cl. 7.01(a) of the assignment of tenancy provided further clarity on effect of cl. 3.02. This clause spelt out the rights and remedies available to the bank, which may be exercised upon default of the borrower of its payment obligations under the facility agreement. In other words, the enforcement rights of the bank cannot be exercised unless there has been a payment default. Clause 3.02 must therefore be read as being subject to this condition, which meant that the assignment of the enforcement rights under cl. 3.02 was a conditional assignment, in that such rights were assigned subject to the condition that they may only be exercised upon a default by the borrower of its payment obligations under the loan.

[22] I accordingly made the finding that the assignment of tenancy was, on its true construction, not an absolute assignment of the tenancy agreement, but merely an assignment by way of security and a conditional assignment. Therefore, Bellajade did not lack locus to prosecute the claim against CME.

Illegality Of The Tenancy Agreement

[23] I found that the tenancy agreement was illegal on the basis that the contemplated use of the premises as specified in s. H of the tenancy agreement (reproduced in para. 8 *ante*) contravened the express condition of title for the land, which restricted the use of the property to residential purposes.

[24] The facts of *Singma Sawmill Co Sdn Bhd v. Asian Holdings (Industrialised Buildings) Sdn Bhd*[2] are directly on point to the issues at hand. In this case, the plaintiff sought to recover arrears of rent from the defendant tenant, who had been let a portion of the plaintiff's land "solely for the purpose of operating a factory". The defendant ceased to pay rental upon being warned by a representative of the Industrial Development Department of the Government of the State of Johore that its factory was operating illegally and in breach of an express condition of title. The land in question was agricultural land and was subject to an express condition that it was to be used for the cultivation of pineapple and rubber. The court made a finding of fact that the defendant was not aware of the express condition at the time it entered into the tenancy agreement and only found out about it when it was warned by the authorities.

[25] The Federal Court in this case affirmed the decision of the trial judge, who held that the plaintiff was guilty of giving an illegal consideration to the tenancy agreement and as such the contract was void under s. 24 of the Contracts Act 1950.

[26] Counsel for Bellajade sought to distinguish the facts of the present case on the basis that:

(a) Dewan Bandaraya Kuala Lumpur had already issued the certificate of fitness for occupation in respect of the premises; and

(b) the process of conversion of the category of land use had already commenced and part of the conversion premium had been paid.

[27] In my judgment, the fact that the certificate of fitness for occupation had already been issued has no bearing on the express condition of title. In addition, the fact that the process of conversion had been commenced did not change the fact that the express condition of title prohibited the use of the building for the purposes specified in s. H of sch. 1 of the tenancy agreement. It is clear that these purposes contemplated the ability of CME to use the premises for commercial purposes and to sub-let portions of the premises to businesses and retailers, which would not come within the category of "kediaman" or residential.

[28] Learned counsel for the plaintiff pointed out that CME nonetheless undertook, after the date on which it had found out about the express condition of title, to settle the arrears in rental due to the plaintiff by 30 April 2014. In addition, rental payments were also made on 24 February 2014. This, argued counsel, indicated that the first defendant CME had acquiesced to the application and imposition of the condition of title and cannot thereafter plead illegality to escape its payment obligations.

[29] In the first place, it is not up to parties to waive the application of an express condition or to modify its applicability by agreement. In *Singma Sawmill*, Raja Azlan CJ (Malaya) said:

> The object of the express condition is that the land must be cultivated with rubber and pineapple; the category of land use is agriculture, and any unilateral conversion to industry is not permitted. Indeed neither party had power to waive the express condition which inextricably runs with the land. If that is permitted it would be entirely to ignore the object of the express condition which is for the public good and to defeat the law relating to land use.

[30] The High Court in *Vijayalakshmi Devi Nadchatiram v. Saraswathy Devi Nadchatiram*[3] disqualified a solicitor from representing her relatives on account of her being pecuniarily interested in the matters litigated and held that acquiescence, waiver and estoppel do not apply to dispense compliance with statutory obligations of an absolute character. In the present case, I would extend the applicable principle further: not only do acquiescence, waiver and estoppel not dispense with compliance with a mandatory requirement of law, but also they do not prevent the first defendant in this case from relying on such mandatory requirement to argue that the tenancy agreement was illegal.

[31] Secondly, the fact that CME did not know about the express condition at the time it entered into the tenancy agreement meant that it could not be taken to have acquiesced to a modification of the use of the premises in the tenancy agreement. The Federal Court in *Singma Sawmill* further stated:

> Appellants' counsel further contended that respondents had acquiesced in the agreement. We think that this is too crude an argument. It overlooks the fact that the respondents were not aware of the express condition until they were warned by the Government Industrial Development Department of the breach. If a man acquiesces to something of which he knows nothing, it is of no real evidential value. "Acquiescence must be founded on a full knowledge of the facts, and further it must be in relation to a transaction which may be valid in itself and not illegal and to which effect may be given as against the party by his acquiescence in and adoption of the transaction". (See *La Banque Jacques-Cartier v. La Banque Depargne De La Cite Et Du District De Montreal* (1887) 13 AC 111, 118).

[32] In the present case, I found that the circumstances that the counsel for the plaintiff relied upon to establish acquiescence do not show that there was full knowledge of the facts on the part of CME.

[33] I therefore found the tenancy agreement to be void under s. 24 of the Contracts Act 1950 on the authority of the *Singma Sawmill* case. The plaintiff's claim against CME was accordingly dismissed.

[34] CME in its counterclaim sought for the return of the sums previously paid as rental under the tenancy agreement, on the basis of s. 66 of the Contracts Act 1950. Section 66 provides:

> When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under the agreement or contract is bound to restore it, or to make compensation for it, to the person from whom he received it.

[35] From the perspective of CME, the tenancy agreement was an agreement that it had discovered to be void, as it was not aware prior to conducting the land searches that the use of the premises as contemplated by the tenancy agreement contravened the express condition of title.

[36] In *Soh Eng Keng v. Lim Chin Wah*[4], Wan Yahya J (as His Lordship then was) delineated the limits of the application of this provision:

> I am of the firm opinion that the words 'discovered' and 'becomes' appearing in s. 66 above are not superfluous words used by the legislators. On the contrary, they are words inserted in that section for a specific reason and that is to qualify or restrict the type of agreement to which that section will apply. As I have said in the earlier case, the term "discover" here clearly indicates something which the parties were unaware of at the time of making the agreement and which they gained sight of or detected subsequently and the word 'becomes' refers to something not present when the contract was signed but came into being at a later stage.

[37] From the perspective of Bellajade, the tenancy agreement was not an agreement that it had discovered to be void, as it knew or ought to have known of the express condition of title. Accordingly, Bellajade cannot avail itself of s. 66 to obtain compensation for the advantage (if any) that had accrued to CME in its occupation of the premises on grounds that CME was unjustly enriched.

[38] I accordingly allowed CME's counterclaim against the plaintiff.

The Guarantee

[39] The threshold issue that arose in connection with the guarantee was whether the obligations thereunder fell away as a consequence of the finding that the tenancy agreement was null and void. The answer to this question depended on whether the guarantee was, on its true construction, merely a contract of guarantee, or whether it was also a contract of indemnity pursuant to which the guarantor undertook obligations as principal to Bellajade.

[40] In my judgment, the plain words of the guarantee made it clear that the guarantee was intended not only for the guarantor to guarantee the payment obligations of CME as tenant under the tenancy agreement, but also for the guarantor to be liable as principal to Bellajade as the landlord. In addition, the obligations of the guarantor were expressed to remain extant in the event that the tenancy agreement was rendered void. The relevant provisions are considered in the following paragraphs.

[41] Clause 2 of the guarantee provided in very clear terms that the invalidity of the tenancy agreement does not affect the obligations of the guarantor:

> 2. I/WE AGREE AND DECLARE that my/our liability under this guarantee shall not in any way be discharged, diminished or affected by the invalidity or unenforceability of the said Tenancy Agreement …

[42] Clause 3 emphasised the point that Bellajade would have been entitled to claim against the guarantor even if it did not have any legal right to claim against CME:

> 3. I/We will jointly and severally on written demand indemnify you against all loss or damage you may sustain under the said Tenancy Agreement whether or not such loss or damage results from the commission of any breach by the Tenant and whether or not you have any legal right to claim against the Tenant for such loss or damaged [*sic*] …

[43] Finally, the opening words of cl. 5 provided for the liability of the guarantor as principal:

> 5. I/We hereby agree that you shall be at liberty to act as though I/we am/were the principal debtor/debtors and not merely as guarantor for the balance rental payable or any part thereof remaining unpaid by the Tenant …

[44] Accordingly, the fact of invalidity of the tenancy agreement did not invalidate the guarantee. However, this did not mean that Bellajade would be entitled to claim against the guarantor. In my judgment, the courts cannot permit Bellajade to claim against the guarantor because Bellajade had participated in the illegality that had rendered the tenancy agreement void. I again turn to the *dicta* of Raja Azlan CJ(M) in the *Singma Sawmill* case:

> … [A] contract which is not in accordance with statutory requirements is no contract at all, and therefore cannot be said to have been discovered to be void under section 66 of the Contracts Act. Nor is it a case of the contract becoming void due to subsequent happenings. The section therefore enacts in statutory form that a contract that is illegal in itself is void and unenforceable by either party. It is contaminated by *turpis causa* and that rule has long been established that *ex turpi causa non oritur actio* - no person can claim any right or remedy whatsoever under an illegal transaction in which he has participated. The courts do not overlook the

A fact that they do not assist a person who comes with unclean hands. In the words of Lindley LJ in *Scott v. Brown, Doering, McNab & Co* [1892] 2 QB 724 728:

> No court ought to enforce an illegal contract or allow itself to be made the instrument of enforcing obligations alleged to arise out of a contract or transaction which is illegal, if the illegality is duly brought to the notice of the court, and if the person invoking the aid of the court is himself implicated in the illegality.

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[45] In my view, the principle *ex turpi causa non oritur actio* would apply equally to defeat the plaintiff's claim under the guarantee. To hold otherwise will result in the somewhat startling position of the plaintiff successfully claiming against the guarantor in respect of an agreement that the plaintiff had by its own actions caused to be rendered illegal.

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[46] Bellajade's claim against the guarantor was accordingly dismissed.

D **Endnotes:**

1. Clause 3.02 of the assignment of tenancy, at B/42 of the common bundle for trial.
2. [1979] 1 LNS 96; [1980] 1 MLJ 21.
3. [1996] 4 CLJ 430.

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4. [1979] 1 LNS 98; [1979] 2 MLJ 91.

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